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FINANCIAL & SUSTAINABILITY REPORT SUMMARY

Financial information is provided on the following pages relative to:

- Current revenues;
- Sustainability analysis based on current plans and assumptions;
- Impact of a legislative referendum proposed in December, 2009, to sweep 50% of voter protected fund balances and revenues;
- The implications of a possible “loan” of FTF funds; and,
- The financial impact of current grant and agreement spending in Fiscal 2010.
- Operations Budget

CURRENT REVENUES:

Current revenues continued to be substantially less than they were in fiscal 2009. December revenues were 20.1% lower than January a year ago and year to date revenues are 16.4% below last fiscal year. Monthly revenues have flattened out around the \$11 million level. (See the Revenue Chart in the attached Sustainability Power Point.)

SUSTAINABILITY:

Little has changed in projected sustainability from what was reported last October. The same growth assumptions have been kept for program and operating expenditures (1%) and future reductions in tobacco revenues has been kept at 4% per year, albeit on a much lower base. As a result, expectations continue that the current levels of investment would continue through at least FY 2017. (See the Sustainability Analysis Graph in the attached Power Point.)

LEGISLATIVE REFERENDUM IMPACT:

The legislative referendum proposed in the House would have taken 50% of each year-end fund balance and 50 % of revenues for each year beginning with FY 2010, the current year, through FY 2013. It would be impossible at this point to take current year ('10) revenues, so the analysis assumed the first diversion of FTF funds would be half of the current year's ending balance. The analysis shows that FTF planned expenditures for FY 2011 would be unaffected as the reserve would still be sufficient to cover the same level of investment adopted by the Board in October of 2009, but spending would have to be

reduced by over 36% for FY 2012 and by more than 63% for FY 2013 due to loss of revenues and reserve balances. The reserve would be completely eliminated by the end of FY 2012. Even after FY 2013, when the state discontinued sweeping revenues, the investment in early childhood would have to be severely curtailed. The only funds available would be revenues received from the declining tobacco taxes. FY 2014 spending, for example, could only be about two-thirds of what was originally projected. (See the attached "Impact of Diversion of FTF Funds" for detailed year by year analysis.)

LOAN OF FTF FUNDS:

Prior to the December special legislative session, FTF suggested an approach to allow the state to access a large portion of its reserve funds to help address its budget problems and the effects cuts are having on young children and their families. The approach would require action to guarantee that any reserve funds "loaned" to the state be repaid, along with interest that would otherwise have been earned on those funds had they continued to be invested through the State Treasurer. This is tricky because a current legislature cannot tie the hands of future legislatures, so how the guarantee is structured is very important to ensure any funds loaned are returned.

The other concern is to limit the funds that could be loaned so that cash flow to pay anticipated monthly expenditures for the early childhood investment is not jeopardized.

The FTF analysis suggests there are ways to accomplish a loan, guarantee a payback and structure the payback so that cash flow would be adequately maintained. Various scenarios have been examined. It has been determined a loan could be done while keeping the sustainability of the early childhood investment unaffected. The analysis examined the effects of FTF loaning \$260 million dollars to the state out of the expected FY 2010 ending balance. The analysis assumes that FTF would loan the money to the state for a period of five years, with a 1% interest fee, while maintaining at least a minimum of \$20 million for cash flow purposes, and with payback to FTF starting in FY 2013.

There are many possible scenarios that can be considered. The examination conducted only looked at the effects of two. The first was a payback in 3 equal payments. The second was a payback with lower initial payments in FY 2013 (to provide more time for economic recovery) and higher payments each of the last two years of the loan. The finding of the analysis is that cash flow could be maintained and the year ending balance for FY 2017 would be approximately the same as it would have been had no loan been made. The acceptability of any loan depends on guaranteeing a specific repayment schedule and the amounts. (See \$260 Million Loan Option write-up.)

FY 2010 GRANTS AND AGREEMENTS:

Grants and agreements are in place and approved by the Board to expend most of the funds allocated to regions for the current fiscal year. It is likely some regions may have unanticipated funds remaining for four reasons:

- Some grants and agreements were not implemented July 1st, so are only effective for part of the fiscal year;

- Some approved strategies are still under development by a Region and it is highly unlikely all the funds approved for that strategy will get expended;
- Some grantees were unable to begin delivering services as quickly as anticipated; and,
- Some grants were unable to be awarded because of a lack of qualified bids received, requiring more work to build capacity to deliver some critical early childhood services in some regions.

Given that:

- some regions will experience higher than expected fund balances this year, and
- have needs for which the funds could be used, either in already approved strategies or to address emergency strategies already adopted by the Board in response to the economic crisis,

It is recommended the Board consider giving Regional Councils the authority to expand approved strategies where grants or agreements now exist in the region and where expansion clearly provides added value for children in the region, or to use funds for emergency strategies previously approved by the Board. This authority would help councils expedite implementing decisions that might help effective use of the funds available occur in a timely fashion. If they were instead to be required to come back to the Board for a modification of their funding plan, it would likely be too late to use the funds where Councils feel great value could be achieved. The Councils would, however, be required to report back to the Board on any changes made in funding their strategies under this Board directive. (No write-up is provided regarding this subject.)

STATUS OF 2010 OPERATING BUDGET:

The last table shows the current fiscal year operating expenditures compared to budgeted amounts. For the year-to-date, operating expenditures are \$651,499 (8.3%) less than budgeted. Savings has been mainly in holding positions vacant, reducing travel, and other operating expenditures. Some positions are scheduled to be filled before the end of the year and at least one additional regional office (Navajo Nation Regional Partnership Council) will be opening in this month. (See attached Operations Expenditure Report for period ending December 31, 2009.)



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SUSTAINABILITY ANALYSIS UPDATE

JANUARY 2010

At this time, the sustainability analysis is based on the revenue and expenditure estimates and budgets approved at the October 27th Board Meeting. No pending legislative actions are included in this analysis update.

Revenue Chart

The last few months have shown a steady decline in revenue, with December's revenues coming in at \$10.8 million. However, the year-to-date average monthly revenue is at around \$11.01 million. Consequently, the projected revenues are still set at \$11.0 million monthly for the rest of FY 2010. The total year-to-date revenues are 16.35% lower than what they were at this time of year last year. We are assuming that some of this decline can be attributed to the overall economic downturn. We continue to project a 4% annual decline in revenues.

Sustainability Analysis Chart

The current sustainability chart shows that, given the estimates for total revenues and expenditures, FTF would be able to sustain programs through July of FY 2018. This assumes:

- 1) 1% annual growth for program spending will be provided for regional program spending;
- 2) Annual growth for administration spending will be limited to no more than 1%;
- 3) The average monthly tobacco revenue will stay at around \$11.0 million through the end of FY 2010;
- 4) The average annual decline in tobacco revenues will be 4%;
- 5) FTF will receive at least a 1% average annual yield on investments starting in FY 2011; and
- 6) Distribution of investment earnings will continue to be 90% to Programs and 10% to Administration.
- 7) No supplemental revenue sources are included at this time.

This chart shows a very slight increase in sustainability over the previous quarter's report. This is mainly due to slightly higher than expected revenues over the last few months, although revenues continue to lag far behind last year's results.

January 2010



Sustainability Analysis Update

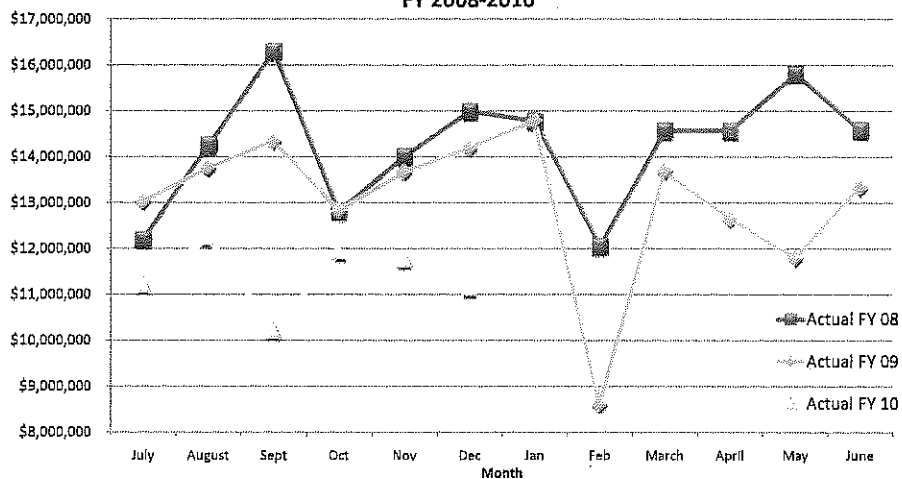
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Revenues



Tobacco Tax & Investment Revenues by Month
FY 2008-2010



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SUSTAINABILITY

Attachment #7

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• SUSTAINABILITY ASSUMPTIONS

- A) 1% Programs Increase
- B) 1% Admin. Increase
- C) \$11million average monthly revenue for the rest of FY 2010, with 4% average annual revenue decline thereafter.
- D) 1% average annual yield on investments
- E) Investment earnings distributed same as revenues

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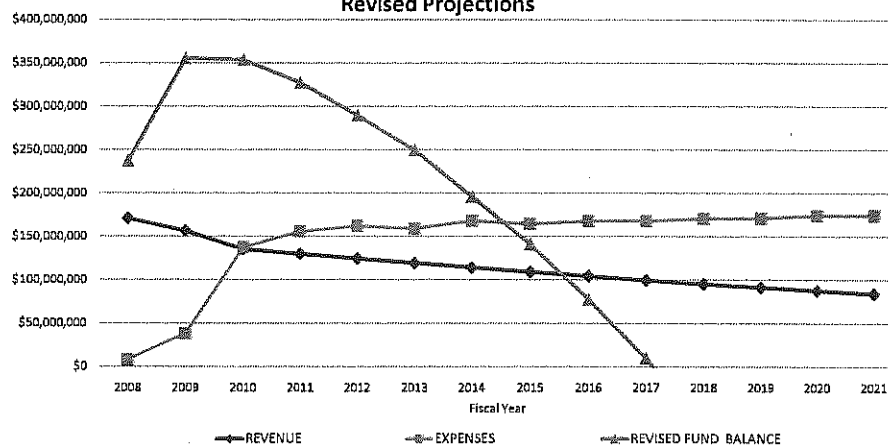
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SUSTAINABILITY

Attachment #7

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SUSTAINABILITY ANALYSIS Revised Projections



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**Impact of Diversion of First Things First Funds
Based on December, 2009 House Proposed HCR
Temporary Suspension of Voter-Protected Funds**

Background

The Legislature pursued a House Concurrent Resolution to temporarily suspend voter-protected funding last December. The referendum would have authorized the legislature to appropriate or divert not more than fifty percent of any fund revenue or fund balance created or allocated to a specific purpose by any measure starting this fiscal year through June 30, 2013. Should such a resolution be passed by the legislature and approved by voters at a special election, the effect would be to devastate FTF funding for young children statewide.

Potential Impact

If the measure is passed, 50% of the fund balance would be swept at the end of this fiscal year 2010 and every year thereafter through FY 2013.

FY 2010 Beginning Balance		362,718,248
Projected Revenue:		135,818,471
Less Expenditures:		
Needs & Assets	500,000	
Operations	15,783,285	
Administrative Expenditures	16,283,285	
AY09 Admin Expenditures	58,903	
Statewide Grant Expenditures	12,824,000	
External Evaluation Expenditures	7,767,949	
Regional Grant Expenditures	107,650,758	
AY09 Program Expenditures	43,806	
Other Expenditures	788	
Total Expenditures	144,629,489	
Ending Balance:		353,907,230
Less 50% of Fund Balance:	176,953,615	
Net Ending Balance		176,953,615

Starting in FY 2011 (although if enacted by a special election yet this year, some of fiscal 2010 revenues could be possibly swept as well), 50% of revenues would be swept on a monthly basis through the end of FY 2013. In addition to lost revenue due to the tobacco tax revenue sweep, investment revenue would also decline as less money will be available for investment.

FY 2011 Beginning Balance		176,953,615
Projected Revenue:		128,449,707
Less 50% of Revenue:	64,224,853	
Less Expenditures:		
Needs & Assets	-	
Regional Evaluations	1,000,000	
Operations	14,680,728	
Administrative Expenditures	15,680,728	
Statewide Grant Expenditures	14,083,500	
External Evaluation Expenditures	4,042,396	
Regional Grant Expenditures	122,715,000	
Total Expenditures	156,521,624	
Ending Balance:		84,656,844
Less 50% of Fund Balance:	42,328,422	
Net Ending Balance		42,328,422

In FY 2012, there would not be enough money in the fund balance to sustain planned expenditures. Total expenditures for the year would have to be cut to 63.59% of the original planned budget. Statewide grant expenditures would be cut from \$14.2 million to \$9.0 million. Regional grant expenditures would be cut from \$123.9 million to only \$79.4 million.

FY 2012 Beginning Balance		42,328,422
Projected Revenue:		121,923,495
Less 50% of Revenue:	60,961,748	
(Leaves \$103.3 million for expenditures.)		
Less Revised Expenditures (63.59% of Planned Spending)		
Needs & Assets (\$1.0M)	500,000	
Regional Evaluations (\$1.0M)	-	
Operations (\$14.8M)	9,400,000	
Administrative Expenditures (\$16.3M)	9,900,000	
Statewide Grant Expenditures (\$14.2M)	9,000,000	
External Evaluation Expenditures (\$7.9M)	5,000,000	
Regional Grant Expenditures (\$123.9M)	79,390,170	
Total Expenditures (\$162.4M)	103,290,170	
Net Ending Balance		0

In FY 2013, with no starting fund balance and the 50% revenue sweep in place, planned spending would have to be cut even more drastically. Total expenditures for the year would have to be cut to 36.7% of the original planned budget. Administrative expenditures would be cut from a planned \$14.9 million to \$5.5 million dollars and there would be no money to spend on regional evaluations

and travel. FTF would have to consolidate regions and implement regional workforce reductions. Program expenditures would also take a big hit. Statewide grant expenditures would be cut from \$14.4 million to \$5.3 million, while regional grant expenditures would be cut from \$125.2 million to only \$46.2 million.

FY 2013 Beginning Balance

0

Projected Revenue:

117,029,349

Less 50% of Revenue:

58,514,675

Less Revised Expenditures (36.70% of Original Budget)

Needs & Assets	-
Regional Evaluations (\$1.0M)	-
Operations (\$15.0M)	5,500,000
Administrative Expenditures (\$16.0M)	5,500,000
Statewide Grant Expenditures (\$14.4M)	5,270,000
External Evaluation Expenditures (\$3.9M)	1,500,000
Regional Grant Expenditures (\$125.2M)	46,244,675
Total Expenditures (\$159.4M)	58,514,675

Net Ending Balance

0

Planned Projected Expenditures and Fund Availability

As you can see below, the effect of this measure would cause problems for FTF for the years following its effective dates as well. Even in FY 2014, when the sweeps would stop, there still would not be enough funds available to FTF to sustain planned projected expenditures.

Year to Year FTF Fund Availability

Fiscal Year	Funds Available	Planned Projected Expenditures
FY 2010	498,536,719	144,629,489
FY 2011	241,178,468	156,521,624
FY 2012	103,290,170	162,437,858
FY 2013	58,514,675	159,423,847
FY 2014	112,348,175	168,142,863

Fund Balance and Revenue Sweeps Summary

Fiscal Year	Legislative Sweep		
	50% of Revenue	50% of Fund Balance	Total Sweep
FY 2010		176,953,615	176,953,615
FY 2011	64,224,854	42,328,422	106,553,276
FY 2012	60,961,748		60,961,748
FY 2013	58,514,675		58,514,675
Totals	183,701,276	219,282,037	402,983,313



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\$260 MILLION STATE LOAN OPTION

Background

The state continues to struggle to be able to balance its budget. Cuts already made have adversely affected services for families and children, and more are likely to come. FTF cannot and should not supplant state funding responsibilities, but may be able to assist in the crisis management by temporarily allowing the state to use some of FTF's financial reserves to balance the state budget. To do so, FTF would have to have a guarantee of payback (including lost interest earnings), plus make sure that it has sufficient reserves and revenues to manage anticipated cash flows.

Finance staff looked at the effects of various scenarios in which FTF would loan \$260 million dollars to the state out of the expected FY 2010 ending balance. The analysis conducted assumes that FTF would loan the money to the state for a period of 5 years (although that time could be shorter or longer depending on the timing and amounts paid back), assumes a 1% interest fee, with payback to FTF starting in FY 2013 (essentially allowing 2 years for economic recovery to kick in) and with maintaining minimum of \$20 million to ensure adequate cash flow management. The first scenario is a payback of 3 equal payments starting in August of FY 2013. The second scenario is a payback with lower payments in FY 2013 to allow the state more time for economic recovery and higher payments during each of the last two years of the loan.

Even Payback Scenario

In the even payback scenario, \$260 million would be loaned to the state at some point during FY 2010. Then, starting in August of FY 2013 through 2015, 3 annual payments of \$91.3 million would be made to FTF to pay back the loan.

Deferred Payback Scenario

In the deferred payback scenario, \$260 million would be loaned to the state in FY 2010. Then, in FY 2013, two payments of \$25 million would be made back to FTF, one in August, 2012 and a second in January, 2013. These payments would then be followed by two more payments of \$58.5 million in September and April of FY 2014 and again in FY 2015 to complete the payback.

The impact of these two scenarios leaves the ending balance at FY 2017 essentially the same as if no loan had taken place. The sustainability analysis before any loan consideration showed an ending balance of just under \$10 million, whereas the two scenarios above show an ending balance of a little over \$10 million.

AZ Early Childhood Development and Health Board
Fund 2543 10 Operations Expenditures
Agency-Wide Admin.
For the Six Months Ending December 31, 2009

FY 2010 Annual Budget

	December			FY 2010			YTD			Amount	% YTD Exp to Budget	% Year Com- pleted
	Budget	Actual	Variance	Budget	Actual	Variance	Budget	Actual	Variance			
<i>Expenditures</i>												
Personal Services (6000)	\$890,411	\$802,345	\$88,066	\$4,122,854	\$4,003,984	\$118,870				\$7,966,918		
ERE (6100)	\$308,372	\$280,559	\$27,813	\$1,427,728	\$1,386,602	\$31,125				\$2,701,420		
Professional & Outside Services (6200)	\$150,481	\$130,118	\$20,363	\$990,651	\$915,587	\$75,064				\$2,000,742		
Travel In-State (6500)	\$46,454	\$19,955	\$26,500	\$278,725	\$107,228	\$171,496				\$706,310		
Travel Out-of-State (6600)	\$4,893	\$2,124	\$2,770	\$27,548	\$8,090	\$19,458				\$63,898		
Food (6700)	\$0	\$0	\$0	\$0	\$428	(\$428)				\$0		
Aid to Organizations (Pass Thru) (6800)	\$0	\$0	\$0	\$0	\$0	\$0				\$0		
Other Operating Expenditures (7000)	\$171,649	\$138,137	\$33,512	\$901,158	\$710,157	\$191,001				\$2,084,970		
Capital Equipment (8400)	\$0	\$0	\$0	\$0	\$0	\$0				\$47,288		
Non-Capital Equipment (8500)	\$4,216	\$7,527	(\$3,311)	\$62,652	\$17,749	\$44,912				\$211,738		
<i>Total Expenditures</i>	<i>\$1,576,476</i>	<i>\$1,380,764</i>	<i>\$195,712</i>	<i>\$7,871,325</i>	<i>\$7,159,826</i>	<i>\$651,499</i>				<i>\$15,783,285</i>	<i>45%</i>	<i>50%</i>
<i>ERE to Personal Services:</i>	<i>35%</i>	<i>35%</i>		<i>35%</i>	<i>35%</i>							
Head Count (Budgeted Positions)	143.75											
Head Count (Filled Positions)	123.00											